



2002 • No. 3

JAPAN:

The Wages of Complacency

Charles Wolf Jr.

Why Japan appears content with stagnation.

[Charles Wolf Jr.](#) is a senior research fellow at the Hoover Institution. He is also a senior economic adviser and corporate fellow in international economics at RAND.

In Japan, economic stagnation is compatible with comfort. Zero or negligible economic growth will still lift per capita income because Japan's population will soon decline. By 2010, the falling population will raise per capita income by nearly one percent every five years, even assuming that the country's gross domestic product remains unchanged. This suggests that Japan's stagnation will continue absent a drastic shock to the system. That shock is just as likely to come from an external source, such as China, as from an internal one.



Illustration by Taylor Jones for the Hoover Digest.

Far from being in a "crisis" condition, Japan remains one of the world's wealthiest countries, with its standard of living among the world's highest. Sales of luxury consumer goods—Louis Vuitton, Gucci, Hermes, and Courvoisier cognac—continue to be strong. Japan's current-account surplus (\$117 billion in 2000) is the world's largest, and its \$400 billion in foreign exchange reserves is almost twice that of second-place China, at some \$203 billion. Its pledge of assistance for rebuilding Afghanistan (\$500 million over two years) is larger than that of the United

States or the European Union. Japan's cities are generally among the world's cleanest and safest. Public services are comparatively reliable and efficient. When travelers step beyond the gate of an arriving flight at the Tokyo or Osaka airport, within five seconds a noiseless and speedy shuttle arrives to move them to another terminal for a connecting flight. It's a sharp contrast to practices at U.S. airports before September 11, let alone since then.

Japan's generally high comfort level is a legacy of the 1970s and 1980s, when its economy was the wonder of the industrial world, recording the highest annual growth rate, averaging about 4 percent, among all developed economies. During this time, Japan became the world's second-largest economy. The explanation for Japan's economic "miracle" was the subject of many an academic and policy debate. The miracle also fostered predictions that Japan's economy would either surpass that of the United States or that Japan would own substantial parts of it.

Japan's protracted stagnation has evoked hardly less wonder and hardly less debate over why the country can't restart its economy. It's a debate tinged with irony. Many of the commentators who previously extolled Japan's economic system and confidently predicted that it would overtake that of the United States are now equally adamant about their diagnoses of Japan's failures. A history of bad predictions apparently hasn't dampened the confidence of the predictors.

To better understand Japan's stagnation in the 1990s, it helps to recall the factors that accounted for the miracle of the 1970s and 1980s: high rates of savings and private investment (although government "guided"); a skilled, vigorous, and growing labor force; a positive rate of productivity growth for both capital and labor; and a monetary policy that provided credit on favorable terms to aggressive, export-oriented industries and firms, especially in the automotive and electronic fields. Taken together, these factors masked the economy's accumulating inefficiencies caused by a protected domestic market and an industrial policy in which government and bureaucracy, rather than competitive markets, determined how and to what purposes resources were allocated. As a result, Japan's economy is marked by an unbalanced industrial structure, financial institutions warped by huge nonperforming loans, and heavy-handed regulation.

The reforms Japan has undertaken to revive economic growth fall somewhere between bland and modest. They have included near-zero interest rates, government bailouts of major banks, increased levels of public spending, and a modest degree of deregulation. Most observers, myself included, think these efforts

are inadequate. Without more drastic deregulation, Japan's near stagnation is likely to continue. RAND forecasts project Japan's annual growth in the first decade of the twenty-first century to hover between zero and slightly above 1 percent.

Since Japan's consumers and political elites seem content to languish in comfort, pressures to deregulate the economy, weed out or consolidate unprofitable firms and precarious banks, and create a new business environment to encourage Japanese entrepreneurs, as well as foreign investors, are unlikely to build. Although President Bush's visit to Japan last February elicited familiar promises of reform, their practical effects are likely to be minimal. Instead, China may be the stimulus that gets Japan's economy growing again.

China has long-standing grievances against Japan stemming from Japan's aggression and oppression in Manchuria in the 1930s and in World War II. Periodically, Japan's reluctance to acknowledge and make amends for its culpabilities—for example, by amending the history texts used in Japanese schools—re-ignites Chinese animosity. If these grievances remain, and if China's economic and military power provide strong and increasing evidence that the country will eclipse Japan in the Asian region, the resulting shock in Japan may have consequences equivalent to those which occurred following the Meiji restoration in the late nineteenth century, when the threat of foreign domination fostered a dramatic political realignment and a drastic redirection in national policy.

This essay appeared in the *Los Angeles Times*, February 24, 2002.

Available from the Hoover Press is *Foreign Policy for America in the Twenty-first Century: Alternative Perspectives*, edited by Thomas H. Henriksen. To order, call 800-935-2882.

[HOOVER HOME](#) | [ABOUT HOOVER](#) | [LIBRARY & ARCHIVES](#) | [RESEARCH](#) | [PUBLICATIONS](#) | [INVOLVEMENT](#)

[HOOVER DIGEST HOME](#) | [PAST ISSUES](#) | [SEARCH](#) | [ABOUT THE HOOVER DIGEST](#) | [SUBSCRIBE](#)